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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

In re

LOGAN T. JOHNSTON, III,

Debtor.

LOGAN T. JOHNSTON, III,

Plaintiff,

v.

UNITED STATES OF AMERICA,
INTERNAL REVENUE SERVICE

Defendant.

Chapter 11

Case No. 2:01-bk-06221-SSC

Adv. No. 2:08-ap-00290-SSC

(For Electronic Docketing Only; Not For
Publication)

**MEMORANDUM DECISION RE
VIOLATION OF THE DISCHARGE
INJUNCTION AND THE
JURISDICTION OF THIS COURT TO
AWARD ATTORNEYS' FEES AND
COSTS**

I. INTRODUCTION

On September 2 and December 16, 2009, this Court conducted hearings in this adversary proceeding to determine whether the United States had willfully violated the discharge injunction and to what extent, as a matter of law, the Ellett Law Offices, P.C. ("Firm"), attorneys for Logan T. Johnston III, could recover their fees and any costs concerning the pursuit of whether the Internal Revenue Service ("IRS"), as an agency of the United States, had violated

1 the discharge injunction of the Debtor.

2 The issues of whether the United States has willfully violated the discharge
3 injunction and whether Debtor's counsel is entitled to attorneys' fees and costs, in prosecution of
4 this adversary, have arisen as the second part of multiple issues that have been presented in this
5 adversary proceeding. On April 17, 2008, the Debtor filed a Complaint, which was amended on
6 April 21, 2008, alleging that the IRS had willfully violated the Debtor's discharge injunction
7 granted under 11 U.S.C. §524. Subsequently this Court determined that the Debtor's claim was
8 against the United States, since the IRS is simply an agency thereof. The parties filed a
9 Stipulation of Facts on February 13, 2009, and Cross Motions for Summary Judgment on
10 February 17, 2009. After oral argument and additional memoranda of law, this Court rendered
11 its Memorandum Decision, dated July 30, 2009,¹ in which it held that (1) to the extent the United
12 States had a defense of sovereign immunity, it was waived,² (2) the Debtor's confirmed plan, as
13 amended ("Plan"), was clear as to the treatment of the "gap" interest of the IRS,³ (3) the Debtor's
14 disclosure statement was not incorporated into the Debtor's Plan, and (4) the gap interest of the
15 IRS was discharged pursuant to the Debtor's Plan.

16 The Court had anticipated that some type of evidentiary hearing would be
17 necessary to resolve the remaining issues in the adversary. However, the Debtor filed instead a
18 Second Motion for Partial Summary Judgment, believing that the Stipulated Facts created a basis
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21 ¹ Docket Entry No. 30.

22 ² The Court concluded that sovereign immunity had been waived for multiple reasons in
23 this adversary. First, the issue was not raised by the United States in its Answer; second, at
24 initial hearings in this adversary, the United States did not raise the issue; and finally, the United
States filed a proof of claim in the Debtor's case. See Memorandum Decision of July 30, 2009 at
5, lines 14-30.

25 ³ "Gap" interest, for purposes of the Memorandum Decision, related to the interest which
26 continued to accrue on the nondischargeable debt, due and owing by the Debtor to the IRS,
27 between the date that the Debtor filed his petition and the date upon which the Debtor's Plan was
confirmed.

1 B. If the answer to Issue A is in the affirmative, whether the Debtor may, as a
2 matter of law, pursue a request for attorneys' fee and costs with this Court.
3

4 IV. DISCUSSION

5 A. Violation of the Discharge Injunction.

6 The United States does not focus on the Debtor's assertion that the United States
7 violated the Debtor's discharge injunction.⁸ Therefore, the Court shall review the facts presented
8 and the arguments of the Debtor.

9 In analyzing the matter, the Court has reviewed 11 U.S.C. §524 (West 2009),
10 which states, in pertinent part,

11 A discharge in a case under this title----
12 (2) operates as an injunction against the . . .
13 employment of process, or an act, to collect, recover
14 or offset any such debt as a personal liability of
15 the debtor. . .

14 The facts herein clearly reflect that the IRS, as an agency of the United States, issued notices of
15 levy in an effort to collect gap interest that the IRS still believed was due and owing on its
16 priority debt which had been already paid by the Debtor.

17 In the decision of Hardy v. United States, 97 F.3d 1384 (11th Cir. 1996), the IRS
18 sought to collect a pre-petition discharged tax liability in violation of the discharge injunction.⁹
19

20 _____
21 ⁸ The United States continues to assert that it did not violate the discharge injunction
22 because the gap interest was not discharged. The reiteration of this argument, already considered
23 by this Court in its July 30, 2009 Memorandum Decision, precipitated the Debtor's Motion to
24 Strike.

25 ⁹ The Circuit Court concluded that under Section 105 of the Bankruptcy Code, the ability
26 to "issue any order, process, or judgment that [was] necessary or appropriate to carry out the
27 provisions of [the Bankruptcy Code]" created "a statutory contempt power, distinct from the
28 court's inherent contempt powers in bankruptcy proceedings." Id. at 1389. As will be
discussed, hereinafter, Section 105 is no longer applicable to a violation of the discharge
injunction.

1 Adopting the two-part test concerning the automatic stay, the Eleventh Circuit stated that in
2 determining whether there had been a willful violation of the discharge injunction, a court should
3 consider (1) whether the defendant knew that the injunction had been invoked, and (2) whether
4 the defendant intended the actions which violated the injunction.¹⁰ The subjective beliefs or
5 intent of the defendant should not be the focus of the court’s inquiry; rather, the court should
6 consider whether the “conduct complied with the order at issue.”¹¹ The Ninth Circuit applies the
7 same test. Havelock v. Taxel (In re Pace), 67 F.3d 187, 193 (9th Cir. 1995).

8 The United States provides no controverting facts in this matter. Relying on the
9 Stipulated Facts, this Court concludes that the United States, through its agency, the IRS,
10 received notice of the Debtor’s discharge in bankruptcy, and was, thus, aware of the discharge
11 injunction. The Court also concludes that the United States intended to issue the notices of levy
12 to collect the gap interest on the Debtor’s priority tax obligation. The actions of the United
13 States, through the IRS, to collect the gap interest were willful violations of the Debtor’s
14 discharge injunction.

15
16 B. Whether the Debtor may pursue his request for attorneys’ fees and costs with
17 this Court.

18 The United States raises a separate issue of sovereign immunity as to the ability
19 of this Court to hear and determine the amount of attorneys’ fees and costs to which the Debtor
20 may be entitled to recover as a result of the United States’ willful violation of the discharge
21 injunction. Although the Debtor filed a separate Motion to Strike the Second Motion for
22 Summary Judgment of the United States, the Court concludes that the argument on the issue of
23 attorneys’ fees and costs is predicated on a number of different statutory provisions that were not
24 previously considered by the Court. Therefore, the Court denies the Debtor’s Motion to Strike

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26 ¹⁰ 97 F.3d at 1390.

27 ¹¹ Id.

1 and will consider the arguments of the United States on the merits.

2 The United States relies on 26 U.S.C. §7430(a)(West 2009) in support of its
3 argument that sovereign immunity has not been waived as to the ability of the Debtor to recover
4 attorneys’ fees and costs. The relevant part of the Section states that the United States waives
5 sovereign immunity “[i]n any . . .court proceeding which is brought . . .against the United States
6 in connection with the . . .collection of any tax, interest, or penalty.” To be awarded a judgment,
7 the party seeking an award must show that it was “the prevailing party” and that the judgment is
8 for “reasonable litigation costs incurred in connection with such court proceeding.” *Id.* at (a) and
9 (a)(2). Section 7430(c)(1) defines “reasonable litigation costs” as being “reasonable court
10 costs.” and ”reasonable fees paid or incurred for the services of attorneys.”¹² 26 U.S.C. §7430
11 (c)(1)(A) and (B)(iii)(West 2009).

12 The United States argues, however, that a party may not seek an award unless it
13 has exhausted certain administrative remedies. Section 7430(b)(1) provides, for instance, that
14 “[a] judgment for reasonable litigation costs shall not be awarded under subsection (a) [of
15 Section 7430] in any court proceeding unless the court determines that the prevailing party has
16 exhausted the administrative remedies available to such party within the Internal Revenue
17 Service.” Because the Debtor has not exhausted such administrative remedies, the United States
18 argues that this Court does not have the subject matter jurisdiction to hear this matter. Without
19 thoroughly discussing the issue, the Eleventh Circuit, in the Hardy decision, remands the issue of
20 attorneys’ fees to the lower courts, and states that any award for a violation of the discharge
21 injunction should be consistent, inter alia, with Section 7430. The United States also relies on
22 Kuhl v. United States, 467 F.3d 145, 147 (2d Cir. 2006) for the same proposition, although the
23 Kuhl decision is not detailed in its analysis as to the application of Section 7430.

24 The problem, as the Debtor points out, is that there are other provisions of Federal
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26 ¹² The Section also provides that unless the court determines “special factors,” the
27 attorney shall not receive a fee in excess of \$125 per hour. Section 7430(c)(1)(B)(iii).

1 law that do not necessarily require the exhaustion of administrative remedies when the United
2 States, through its agency the IRS, violates the discharge injunction.

3 11 U.S.C. §106(a) provides that sovereign immunity is abrogated as to a
4 “governmental unit” with respect to “(1) Sections 105. . . .524...” of title 11. Section 101(27)
5 defines “governmental unit” as, without limitation, the United States, as well as an “agency” of
6 the United States. 11 U.S.C. §101(27)(West 2009). Section 106 further provides that the
7 bankruptcy court may “hear and determine any issue” concerning the application of Sections 105
8 or 524 to the “governmental unit” and that the bankruptcy court may enter an order or judgment
9 awarding a “monetary recovery.” 11 U.S.C. §106(a)(2) and (3). Section 106(a)(3) also states
10 that

11 Such order or judgment for costs or fees under [title 11] or the Federal Rules of
12 Bankruptcy Procedure against any governmental unit shall be consistent with the
13 provisions and limitations of section 2412(d)(2)(A) of title 28.

14 Section 2412 of Title 28 serves as a limitation on the attorneys’ fees and costs that may be
15 recovered by the prevailing party in any civil action brought against the United States or any of
16 its agencies. 28 U.S.C. §§2412(a), (b), and (d)(2)(West 2009). Thus, Section 2412 serves as a
17 limitation on the amount of any award that may be entered by the bankruptcy court for a
18 violation of Sections 105 and 524, but it is not a prohibition against the bankruptcy court hearing
19 the matter.

20 Moreover, in 1998, a specific provision was added to the Internal Revenue Code
21 which considered how an individual should proceed in the context of obtaining a civil damage
22 award for a violation by the IRS of Section 524, the discharge injunction.¹³ 26 U.S.C.
23 §7433(e)(West 2009) states, concerning actions in violation of “certain bankruptcy procedures”
24 that

25 If, in connection with any collection of Federal tax

26 ¹³ This Section was added as a result of repeated violations of the discharge injunction by
27 the IRS.

1 with respect to a taxpayer, any officer or employee
2 of the Internal Revenue Service willfully violates any
3 provisions of section .. 524 (relating to the effect
4 of discharge) of title 11, . . .such taxpayer may petition
5 the bankruptcy court to recover damages against the
6 United States.

7 Of importance in trying to reconcile these various provisions is the fact that most of the cases,
8 such as In re Hardy, were decided prior to the amendment in 1998 of the Internal Revenue Code,
9 which added Subsection (e). Thus, the United States' current reliance on case law prior to 1998
10 is inapposite. This Court assumes, as it should, that Congress acted intentionally when it
11 amended Section 7433. DeVargas v. Mason & Hanger-Silas Mason Co., Inc., 911 F.2d 1377,
12 1388 (10th Cir. 1990) (Congress amends laws to comport with its intentions.) Section 7433(e)
13 provides that the bankruptcy court "may hear" an action by a debtor/taxpayer with respect to any
14 officer or employee of the IRS who willfully violates the discharge injunction under Section 524
15 of the Bankruptcy Code. Thus, Section 106 appears to provide this Court with the subject matter
16 jurisdiction to hear and determine whether the Debtor's Firm should recover its attorneys' fees
17 and costs.

18 Section 7433(e)(2)(A) also states that notwithstanding Section 105 of title 11, the
19 petition to the bankruptcy court under Section 7433(e) shall be the "exclusive remedy" for
20 recovering damages resulting from a violation of the discharge injunction. 26 U.S.C.
21 §7433(e)(2)(A)(West 2009). Since it is the exclusive remedy, Section 7430 of the Internal
22 Revenue Code which focuses on awarding costs and attorneys' fees in a "court proceeding" may
23 be limited in its application to other proceedings or actions that may be brought by a taxpayer in
24 a federal court or to those type of actions which are subsumed within Section 7433(e)(2)(B)(i).
25 As described more fully hereinafter, the facts of this case suggest that Section 7430 is not
26 applicable to the issues before this Court.

27 The Court also concludes that because of the exclusive remedy language of
28 Section 7433(e)(2)(A), Section 7433(d), which purports to require that no judgment for damages

1 may be obtained in any court for unauthorized collection actions by the IRS against a taxpayer
2 unless the debtor/taxpayer has exhausted his or her administrative remedies, does not apply to a
3 debtor seeking relief under Section 7433(e)(2)(A). In fact, Section 7433(d) states that the
4 limitation on the taxpayer's ability to proceed in court until he or she has exhausted the IRS'
5 administrative remedies only pertains to "subsection (b)." In turn, Subsection (b) only pertains
6 to an action which is brought under Section 7433(a). Finally, Section 7433(a) is only a general
7 provision which relates to an officer or employee of the IRS who "recklessly or intentionally, or
8 by reason of negligence" disregards any provision of, or regulation promulgated under, the
9 Internal Revenue Code.¹⁴ As already discussed with respect to Section 7430 of the Internal
10 Revenue Code, if Congress has created a specific provision which focuses on actions that a
11 debtor/taxpayer may take, that specific provision shall control over the general provisions. Thus,
12 the specific provision of 26 U.S.C. §7433(e)(2)(A) must control over the general provision of
13 Section 7433(a).

14 Finally, Section 7433(e)(2)(B) states that the exclusive remedy provided under
15 Subsection(e)(2)(A) need not apply to an action under section 362(h) concerning a violation of
16 the automatic stay.¹⁵ Apparently Congress determined that at least as to an individual debtor,
17 there should be additional basis to claim relief. However, if the individual decides to pursue
18 other actions against the IRS, Subsection (e)(2)(B)(1) requires that the attorneys' fees and costs
19 only be awarded under Section 7430 of the Internal Revenue Code, which necessitates
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22 ¹⁴ The reference in Section 7433(a) is to improper actions by an IRS officer or employee
23 "under this title." Since the Section was enacted under title 26, the reference is to the Internal
24 Revenue Code.

25 ¹⁵ It does not appear that the Internal Revenue Code has been amended to incorporate the
26 2005 amendments to the Bankruptcy Code. Section 362(h), pertaining to the ability of an
27 individual to pursue a willful violation of the automatic stay, has been re-designated Section
28 362(k)(1) as a result of the changes enacted by the Bankruptcy Abuse Prevention and Consumer
Protection Act of 2005 ("BAPCPA").

1 exhaustion of administrative remedies.¹⁶

2 The IRS does cite this Court to the decision of Kuhl v. United States, 467 F.3d
3 145 (2d Cir. 2006), which was decided after the insertion of Subsection (e) into §7433 of the
4 Internal Revenue Code. The facts of that case reflect that on February 10, 2000, the debtor filed
5 her chapter 7 bankruptcy petition, and in May 2000, received her discharge. Id. at 146. On
6 February 27, 2003, the IRS, by notice of levy, commenced garnishment of the debtor’s wages to
7 satisfy allegedly outstanding tax liabilities. Id. The debtor protested the actions of the IRS, and
8 ultimately, in the fall of 2004, the bankruptcy court discharged any remaining tax liability. Id. at
9 146-147. However, the bankruptcy court denied her request for sanctions. On appeal, the
10 Second Circuit considered to what extent to the debtor could pursue her claim for attorneys’ fees
11 as a result of the actions of the IRS. Id. at 147. The Second Circuit stated

12 Congress has conditionally waived sovereign immunity for the IRS’ willful
13 violation of such a discharge: after exhausting administrative remedies,
14 the taxpayer may petition the bankruptcy court for damages.

15 Id. at 147. The Second Circuit cites to not only Section 7433(e) of the Internal Revenue Code,
16 but also to an Internal Revenue Service Regulation, 26 C.F.R. §301.7433-2(b)(2)(West 2009),
17 which should provide guidance concerning an action that is commenced under §7433(e). Id.
18 However, the Second Circuit only cites to part of the Regulation. Referring first to Subsection
19 (b)(2), concerning the “litigation costs and administrative costs,” the Second Circuit concludes
20 that such litigation costs are not recoverable as “actual, direct economic damages,” but may be
21 “recovered under [26 U.S.C.] section 7430.” 467 F.3d at 147. However, a review of Subsection
22 (b)(2) of the Regulation reflects that the reference to “litigation costs and administrative costs”
23 refers back to actions concerning the violation of the automatic stay, not necessarily the

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25 ¹⁶ Although not relevant to the ultimate determination of the issues presented herein,
26 Subsection (e)(2)(B)(ii), in the phrase “certain other actions permitted,” also includes the ability
27 of a taxpayer to recover “administrative costs” from the bankruptcy court if incurred on or after
28 the date that the bankruptcy petition has been filed. Presumably such post-petition expenses
refer to administrative expenses under Section 503 of the Bankruptcy Code.

1 discharge injunction. Without discussing the issue further or discussing the specific Regulation
2 applicable to actions under Section 7433 of the Internal Revenue Code, the Second Circuit
3 simply turns to a discussion of Section 7430 and 26 C.F.R. §301.7430-1(West 2009), the
4 Regulation thereunder. Id. At least as to the facts in this case, this Court disagrees with the
5 Second Circuit’s sole reliance on 26 C.F.R. §301.7430-1(West 2009).

6 Although not discussed in Kuhl, another Subsection of the Regulation concerning
7 Section 7433 of the Internal Revenue Code appears more relevant to the issues before this Court.
8 26 C.F.R. §301.7433-2(d)(2)(West 2009) states that although an administrative claim should
9 generally be filed first with the IRS before filing an action with the bankruptcy court, there is an
10 exception when the “administrative claim is filed in accordance with paragraph (e) of this section
11 during the last six months of the period of limitations described in paragraph (g) of this
12 section....” Under such a factual predicate, the debtor need only file the administrative claim
13 with the IRS, and then may immediately file an action with the bankruptcy court. 26 C.F.R.
14 §301.7433-2(d)(2). In turn, Paragraph (g) states, in pertinent part:

- 15 (1). . .A petition for damages under paragraph (a) of this section
16 must be filed in bankruptcy court within two years after the date
17 the cause of action accrues.
18 (2) . . .A cause of action under paragraph (a) of this section
19 accrues when the taxpayer has had a reasonable opportunity to
20 discover all essential elements of a possible cause of action.

21 26 C.F.R. §301.7433-2(g)(West 2009). Thus, if a debtor discovers a claim concerning a
22 violation of his or her discharge injunction, the debtor must file an action with the bankruptcy
23 court within two years of that discovery, assuming the debtor has had “a reasonable opportunity
24 to discover all essential elements of a possible cause of action” during that time period. In turn,
25 if it is nearing the end of the two-year period, the debtor may file an administrative claim with
26 the IRS, and then immediately file an action with the bankruptcy court if there is only six months
27 left before the two-year period is about to expire.

28 The Debtor herein received his first notice of tax levy from the IRS shortly after

1 April 30, 2006.¹⁷ The IRS concedes that three additional notices were sent to the Debtor. The
2 parties have not stipulated, and there is no evidence in the record, as to when the Debtor should
3 have had a “reasonable opportunity to discover all essential elements of a possible cause of
4 action.” Certainly the Debtor did not anticipate any claim for gap interest. The Debtor paid the
5 IRS priority claim shortly after his Plan was confirmed in 2005. There is nothing in the record to
6 indicate that the IRS ever asserted a gap interest claim until it commenced sending the notices to
7 the Debtor in April of 2006. On April 17, 2008, within the two-year period after the Debtor first
8 received his notice of levy concerning gap interest, the Debtor filed his complaint with this Court
9 concerning a violation of his discharge injunction. Until the current opposition to the Debtor’s
10 Second Motion for Summary Judgment, the IRS has never raised the issue of the Debtor’s failure
11 to file an administrative claim first with the IRS before filing this adversary with the Bankruptcy
12 Court as depriving this Court of subject matter jurisdiction over the matter. Until the current
13 opposition, the IRS has also never raised the issue of the Debtor’s failure to file his claim or
14 action within the applicable statute of limitations.¹⁸ Moreover, when the Debtor did try to file an
15 administrative claim with the IRS after the entry of this Court’s July 30, 2009 Memorandum
16 Decision, either the IRS or the United States requested an immediate stay to delay the processing
17 of the Debtor’s claim. Indeed another provision of the Regulation concerning actions under
18 Section 7433 of the Internal Revenue Code contemplates that the IRS may take no action on a
19 claim. 26 C.F.R. §301.7433-2(d) states, in part:

20 : . . .no action under paragraph (a)(1)[pertaining to a petition for
21 damages under sections 362 or 524] . . .shall be maintained in
22 any bankruptcy court before the earlier of the following dates—
23 (i) The date the decision is rendered on a claim filed in accordance
24 with paragraph (e) of this section; or
(ii) The date that is six months after the date an administrative claim
is filed in accordance with paragraph (e) of this section.

25 ¹⁷ See Stipulated Facts of the parties, ¶M, Docket Entry No. 19.

26 ¹⁸ See Docket Entry No. 9, Answer to Amended Complaint and Docket Entry No. 24,
27 United States’ Opposition to Plaintiff’s Motion for Partial Summary Judgment.

1 the Court through a further stipulation or which must be resolved by an evidentiary hearing. The
2 Court is also mindful that if the statute of limitations has run as to the Debtor's claim, if the
3 Debtor did not timely file his administrative claim with the IRS, given the unique facts of this
4 case, or if the Debtor has no actual, direct economic damages, the Court may need to rescind its
5 determination that the IRS has willfully violated the discharge injunction. The Court will issue a
6 separate notice, setting a further Federal Rule of Bankruptcy Procedure 7016 Scheduling
7 Conference to determine how to resolve the remaining issues in this adversary proceeding.

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10 Dated this 22nd day of March, 2010.

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13 The Honorable Sarah Sharer Curley
14 United States Bankruptcy Judge

15 BNC to notice.
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